Public Debt

Meaning of Public Debt

When the planned expenditure of the government exceeds its total revenue, the government needs to borrow money from individuals and organisations. This is called public debt.

- Three Sources of Public Borrowings
  - An individual may purchase government bonds and other types of securities.
  - Banks may also purchase government bonds. Banks are forced to hold government securities in a certain proportion to their deposits.
  - The government can raise external loans from international agencies such as the International Monetary Fund and the World Bank.

- Differences between Public and Private Debts

Public Debt	Private Debt
The government can frequently avail long-term loans.	Individual or private companies cannot take long-term loans.
Generally, the government takes loans for the welfare of the people.	Individuals take loans to maximise their profits and satisfaction.
The government can avail loans at a low interest rate because of its credit worthiness.	The individual has to pay a high rate of interest because of the lender's risk in providing loans.
The government's source of borrowing can be availed within the nation and abroad.	Individual loans are limited within the nation only.

- Similarities between Public and Private Debts
  - Both government and individuals take loans to bridge the gap between income and expenditure for their day-to-day activities.
  - They take loans for specific periods at a fixed rate of interest.

Structure of Public Debt

- Internal and External Debts

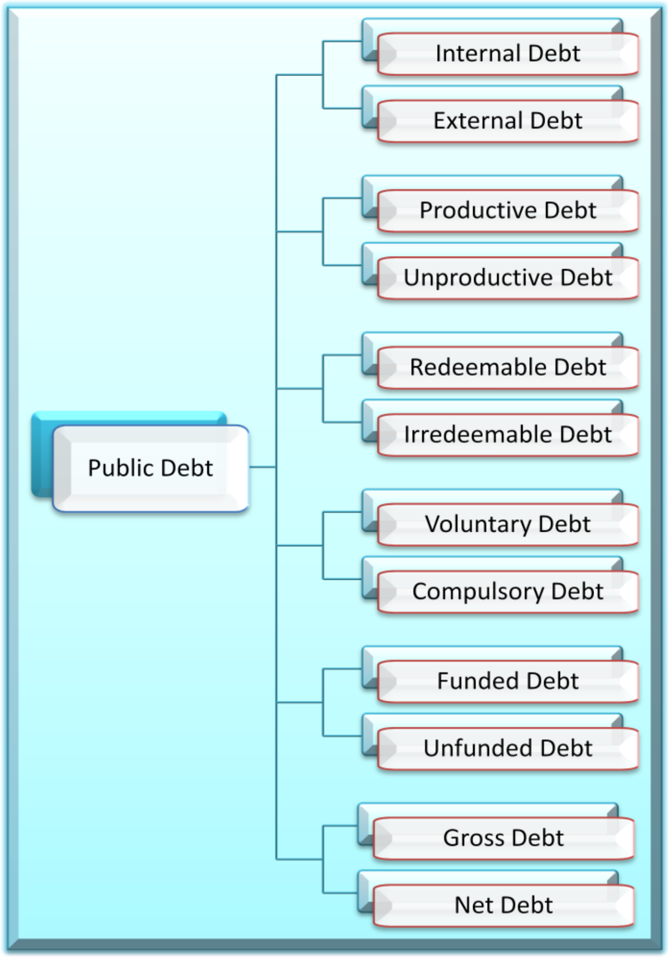
Internal debt is the government's borrowings within the country. Individuals, banks, business firms and others are the various internal sources from which the government borrows. The various instruments of internal debt include market loans, bonds, treasury bills, ways and means and advances.

External debt is the government's borrowings from abroad. The external debts are multilateral borrowings, bilateral borrowings, loans from the World Bank and the Asian Development Bank. It helps various developmental programmes.

- Productive and Unproductive Debts

A debt is called productive if the loan is financed for projects which bring revenue to the Government; for example, irrigation and power projects. Productive debts are self-liquidating; this means the principal amount and interest are normally paid out of the revenue generated from the projects for which the loans were used.

A debt is called unproductive if the loan is financed for war and other relief operations in case of emergencies. Unproductive public loans are a net burden on the community. The government will have to resort to additional taxation for their servicing and repayment.



- Redeemable and Irredeemable Debts

A redeemable debt is that which the government repays after a fixed period of time. When the government borrows money from the public, it sells securities to the public. They pay the interest at regular intervals. When the debt matures, the public surrenders the security to the government and receives the principal along with the interest amounting anything because of them. Banks and other institutions are the holders of government securities.

Irredeemable debts are the loans for which no promise is made by the government regarding their exact date of repayment. Such debt has no maturity period. The government may pay interest regularly. Normally, the government does not resort to such borrowings.

- Voluntary and Compulsory Debts

If the government raises public debt without putting any compulsion on the buyers of government bonds, it is called voluntary debt. Most of the public debts are voluntary.

If the lenders purchase government bonds under compulsion, it is called compulsory debt. Here, the loan must be compulsorily subscribed on the same basis as a tax.

- Funded and Unfunded Debts

If the government makes arrangements for a separate fund for meeting debt obligations, it is called funded debt. It is also called long-term debt.

While taking a loan, if the government does not create any separate fund for the repayment of principal amount along with interest, it is called unfunded debt or floating debt. These debts are short-term debts. Generally, these debt obligations are cleared within a year.

- Gross and Net Debts

The total sum of all the debts is called gross debt, and the net debt is the balance amount of debt after exclusion of sinking fund and other assets meant for repayment of loans.

Role of Public Debt in the Indian Economy

- To meet the budgetary deficit: Public debt is raised to bridge the gap between public expenditure and tax revenues of the government. In case the government revenue from taxes and other sources is insufficient to meet public expenditure, then the government borrows money.
- To finance development plans: The government has to finance developmental projects. In India, the government has to play a significant role for the development plans of the economy. Hence, the government borrows from the public to maintain the required funds.
- To build infrastructure: In a developing country like India, the basic infrastructure facilities are essential for the process of development. These investment plans are less attractive to private companies as their returns are minimal. Hence, the government has to borrow money to invest in these projects.

Growth of Public Debt in India

Over the years, the internal debt of the central government has increased from Rs 1,54,004 crore in 1990–91 to Rs 23,37,682 crore in 2009–10, and the external debt of the central government has increased from Rs 31,525 crore in 1990–91 to Rs 1,39,581 crore in 2009–10.

Effects of Public Debt

- Burden of Public Debt

Public debt is raised by the government when its taxation revenue is insufficient to meet public expenditure. If the government borrows more than the required amount, it may lead to a debt trap situation. In such circumstances, the government borrows to pay interest on old debts. This will impose a greater burden on society. External debt leads to an outflow of economic resources from the country. When the loan is availed from foreign agencies, the interest payments will flow from the domestic nation to the foreign nation. Added to this, if there is any condition applied in the loan process that the required inputs for the project will be purchased from abroad rather than within the domestic nation, the burden of external debt will be still greater.

- Inflationary

A major part of the funded debt loans are held by the Reserve Bank of India (RBI). This enables the RBI to issue additional quantity of money to the public to meet its growing demand for the development of an economy. The government takes short-term loans by issuing treasury bills which are held by the RBI. These treasury bills indicate deficit financing by the government. Hence, public debt has an inflationary effect on the economy.